



ECONOMIC POLICY UNCERTAINTY AND CAPITAL MARKET DEVELOPMENT IN NIGERIA: MEDIATING ROLE OF POLITICAL STABILITY

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Abstract

Global development, government meddling in daily economic affairs, and capital market factors are all to blame for the steady global expansion of economic policy uncertainty (EPU). Economic agents react differently to uncertainty policies, even though they disrupt some sectors. This is especially true when an unexpected shock is present. The study objective is to determine how EPU and capital market development proxied with market size capitalisation relate with mediation of political stability in Nigeria from 1995 to 2024. Yearly data and an ex post facto study design were used. Finding revealed that the money supply, interest rates, crude oil prices, and the economic uncertainty index all had a considerable impact as well as mediating influence of political stability with EPU strongly determined stock market size capitalization. Thus, the study concluded that domestic and foreign investors should varied across sectors and maximum observation should be on the political stability regarding its policies ad institutions so as to lessen quantum of risk exposure from unpredictable economic policies, sharp practices and this will enhance capital market patronage which will boost market size capitalization in the Nigeria exchange group (NGX).

Keywords: Interest rate, money supply, stock market capitalisation, political stability, uncertainty index

1. Introduction

Political stability constitutes a critical dimension of institutional quality that investors consider when making investment decisions. For an economy to attain sustainable growth and development, policymakers must give adequate attention to capital market development and political stability within the broader economic policy framework (Fakunmoju, 2024). Political stability reflected in the quality of public service delivery, the formulation and implementation of sound policies, and the credibility of economic governance, plays an important role in promoting capital market development. However, Nigeria has experienced difficulties in achieving its capital market development objectives due to persistent structural, institutional, and political constraints.

Globally, capital markets perform an essential function in contemporary economic systems by facilitating the mobilisation and efficient allocation of financial resources between investors and firms. Existing scholarly evidence indicates that a well-developed stock exchange provides listed companies with access to long-term capital needed to finance investment opportunities, support business expansion, and maintain an appropriate capital structure that balances risk and return (Fakunmoju, 2024). Nevertheless, weak political stability, distorted economic policies, inadequate accountability, and limited enforcement against unlawful conduct by public officials may

discourage both domestic and foreign investors from participating in the capital market. These challenges are particularly pronounced in countries with high levels of perceived corruption and weak institutional capacity to prevent and address corrupt practices.

Perhaps as old as humanity itself, political stability is still a widespread problem that affects people's lives, countries, and civilizations all over the world especially developing economies like Nigeria. A nation's social, economic, judicial, and political systems are often at risk due to Government ineffectiveness and uncertainty macroeconomic policies. Government ineffectiveness in Nigeria give room for visible and invisible corrupt practices like front-running or tailgating, spoof trading, naked short selling and pump and dump schemes in Nigeria capital market which discourage stock investors to participate in stocks trading, condensed stock patronage and unstable stock market capitalization proxied for capital market development especially among developing stock market. As stated by Eshun and Tweneboah (2024) Government ineffectiveness is a bad influenced that progressively and mutely drains market development. The worry of scholars is how would stock developed and interact with political stability and economic uncertainty known with developing economies like Nigeria.

Capital market is a worldwide phenomenon that serves as a platform for financial activity in industrialized, emerging, and developing economies as well as an intermediary between surplus and deficit units. Stock market size capitalization as proxied for capital market development that improve the financial intermediation process of transferring excess funds to deficiency investors or units. According to Fakunmoju (2024) capital market development is the increase in stock capitalisation size and trade volume in the capital market. More options and possibilities to invest in the capital market improve risk management practices, access to financial instruments, and healthier returns for cautious stock investment. Well-developed capital market enhances the efficient allocation of financial resources, strengthen risk-sharing mechanisms, and promote transparency and good corporate governance. Through these channels, capital market expansion contributes to improved growth prospects by creating broader investment and financing opportunities for economic agents. Empirical evidence on capital market development indicator shows that Nigeria recorded stock market size capitalization in the year 2025 hit \$110,780,570,049.60 Billion while as at April 2026, market capitalisation stood around \$96,942,249,008.00 Billion, this is an indication of drop in the capital market development unlike the Johannesburg Stock Exchange which remains Africa's largest stock market, accounting for 60% of the continent's total equity value and hit \$1.02–1.30 trillion in year 2024 and \$1.46 trillion in 2025. This drop in the Nigeria capital market can be traced to uncertainty economic policies and Government ineffectiveness in Nigeria (World Bank, 2025).

Economic policy uncertainty (EPU) describes a condition in which government economic policies are unpredictable and subject to frequent change. It captures uncertainty related to monetary, fiscal, and regulatory policies, mainly driven by the risk that existing policy arrangements may be altered over time (Danisman, Ersan, & Demir, 2020). EPU focuses on the unclear consequences that actual or anticipated policy actions by economic authorities may have on the private sector and overall economic performance (Ng et al., 2020). In Nigeria, rising uncertainty about economic policy has become a key factor shaping stock market outcomes. Following the global financial crisis of 2007–2009, concerns intensified among policymakers regarding the influence of EPU on financial systems worldwide. Empirical studies, including those by Baker et al. (2016), Lo and

Rogoff (2015), Nagar et al. (2019), Liu and Zhang (2020), and Ozili (2021), provide evidence that heightened policy uncertainty contributed to slow post-crisis recovery in both advanced and emerging economies.

EPU represents the likelihood that current policy frameworks may be revised, thereby influencing investor expectations and financial development decisions. When economic policy direction is unclear, investors and firms often delay or reduce investment commitments, which can weaken stock market development in Nigeria. In such environments, economic agents typically become more cautious in their spending and portfolio choices due to limited clarity about future economic conditions. Nigeria's experience of EPU has stemmed from several sources, including fuel subsidy reforms, proposed changes to bank capital structures, fluctuations in global oil prices, oil-related shocks, the adoption of a floating exchange rate regime for the naira against the US dollar, sudden central bank policy interventions, and inconsistent government policy responses (Ozili, 2021; Salisu et al., 2023). Collectively, these factors highlight the persistent and context-specific nature of EPU in Nigeria.

Capital market investments in Nigeria have suffered due to widespread of Government ineffectiveness in every sectors. Promoting private investment and creating an investor-friendly business climate in Nigeria are the main goals of economic regulators (African Economic Outlook, 2011; 2020; 2022; 2024). Despite the effort of President Tinubu led Administration, Government ineffectiveness enhance corrupt practices; where Nigeria corruption perception index was 26 out of 100, this places Nigeria among the most corrupt nation in the world with perceived level of public and private sectors corruption (Transparency International Report, 2025). With these high rank corruption profile and economic policy uncertainty, Nigeria stock exchange group (NGX) suffer setback in the ratio of stock market capitalization to gross domestic product from 13.088 in the year 2023, 33.6640 in the year 2024 and sharp declined to 19.1534 in the year 2025. This sharp declined of market capitalization to gross domestic product was due to high level of Government ineffectiveness and economic policy uncertainty resulting from low patronage form domestic and foreign stock investors.

The mediating effect of Political Stability (PS) with EPU on capital market development measured by market size capitalization has not received empirical attention both within Nigeria and in the broader international literature. Despite growing empirical evidence suggesting that heightened economic policy uncertainty may adversely affect stock market development. Consequently, a clear gap exists in the empirical literature, which this study seeks to fill. Existing studies have largely focused on how EPU affect stock market development (Ahir et al., 2022; Al-Thaqeb & Algharabali, 2019; Alawadhi et al, 2021; Bahmani-Oskooee & Saha, 2019; Riaz, Hongbing, Hashmi, & Khan, 2018; Zalla, 2016; Aroui et al., 2016; Raulatu et al., 2019; Ukwueze et al., 2018; Salisu et al., 2023). Based on past empirical studies reviewed, there is no empirical evidence that past studies focused on mediating influence of political stability with EPU on stock market development proxy with stock market size capitalization in Nigeria. Thus, the empirical gap identified motivate this study. Further section presented related literature review with hypothesis development based on empirical gap established. Section three focuses on research methods. Section four dwell on result and discussion and finally section five offers conclusions and future research suggestion.

2. Literature Review

Capital Market Development

Fakunmoju (2024) conceptually defined capital market development as the growth and extension of a stock market, including more market capitalization, better liquidity, and higher participation with increase in the size of capital invested the NGX. In essence, it entails developing a more dynamic and effective marketplace where investors can trade stocks, other securities and businesses may raise financing. Thus, this study proxied capital market development with market capitalization. Stock market size capitalization is the cumulative value of all securities traded on a stock exchange, reflecting the combined valuation of firms listed in the market. It provides a broad measure of the overall magnitude and economic significance of the stock market.

Economic Policy Uncertainty (EPU)

EPU arises when economic agents are unable to clearly anticipate the timing, direction, or nature of changes in government economic policies, as highlighted by Gulen and Ion (2016). In a broader sense, it reflects the influence of unstable policy and market conditions on economic decision-making and the behavioural responses of firms, investors, and households. In Nigeria, EPU is often rooted in political and regulatory actions that shape both current and expected future economic decisions. Qijiao (2021) further characterizes economic policy uncertainty as the outcome of abrupt or unforeseen policy choices by governments or regulatory authorities across various sectors of the economy, which subsequently affect how consumers and other economic actors adjust their behaviour.

Political Stability

Political stability is the extent to which a country's political system and governing institutions remain secure, orderly, and predictable, with a low probability of government destabilisation, political violence, civil unrest, or terrorism. A stable political environment promotes policy consistency, reduces uncertainty, and strengthens investor confidence, thereby supporting economic and financial market development (Kaufmann et al., 2024; World Bank, 2025)

Theoretical Framework

This study was grounded by real options theory and precautionary savings theory, as both theories established the link between EPU, political stability and capital market development

Real Options Channel Theory

The real options theory, introduced by Bernanke (1983) and Brennan and Schwartz (1985), suggests that firms possess multiple strategic choices when considering potential investments. This theory highlights the importance of flexibility for investments that are irreversible or difficult to reverse. When an investor commits to such a project, withdrawing from it would involve substantial costs. By postponing the investment, the investor sacrifices immediate returns but retains the opportunity to invest later, allowing time to gather additional information that may lead to better decisions. Consequently, in situations where the costs of reversing an investment are high, uncertainty encourages firms to act cautiously in their investment and hiring decisions (Ogbuabor, Onuigbo, Orji, & Ojonta, 2021). Therefore, unexpected events and unpredictable conditions can significantly influence investment behavior within an economy.

Precautionary Savings Channel Theory

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Precautionary saving, as described by Carroll and Kimball (2016), refers to the extra savings households accumulate in response to uncertainty about future events that could impact income or investment. To mitigate potential risks, households may save more by cutting back on current spending or increasing labor effort. In this sense, precautionary saving reflects adjustments in present consumption made in anticipation of future uncertainties. Leland (1968) notes that when future income is uncertain, households tend to save more, especially when they are less risk-averse. Under uncertain conditions, economic agents often reduce consumption and raise output to protect themselves from potential negative shocks. Research by Salisu et al. (2023) confirms that higher uncertainty about future household income encourages precautionary saving, while Moore (2016) shows that slower growth in consumption of durable goods and overall economic uncertainty can lead to an increase in household saving rates. In summary, the precautionary savings channel indicates that rising savings can curb household consumption but may support greater investment. Combined with the real options theory, this framework helps explain how uncertainty shapes macroeconomic investment decisions.

Empirical Review and Hypotheses Development

Despite several related studies reviewed below, no known studies to the best of researcher's knowledge examined how political stability mediate with EPU on capital market development. Fakunmoju (2024) analyzed the link between EPU and stock market development in Nigeria and found that EPU significantly influenced stock trade volume as a proxy for stock market development. Similarly, Omodero and Dandago (2018) studied in Nigeria, the link between corruption and stock market performance, establishing a direct and weighty influenced of corruption perception index on share price index proxied for stock market performance. However, neither study explored the interactive effect of political stability (PS) with EPU on capital market development in Nigeria.

Other empirical explore the influenced of EPU on investment and stock market performance in international contexts. Gilal (2019) examined EPU and stock returns in Indonesia, while Baker, et al. (2021) investigated how policy uncertainty influenced corporate investment. Their findings indicate that EPU discourages investment due to precautionary delays in irreversible projects and adversely influences returns in Indonesia market. Bahmani-Oskooee and Saha (2019), using a non-linear autoregressive distributed lag (NARDL) approach, found that policy uncertainty had inconsistent short-term effects on price of stocks in the USA, Canada, United Kingdom, and South and North Korea, but the five stock markets exhibit worthy long-term impressions. Rising policy uncertainty depressed returns on stock in the short term, whereas declining uncertainty exhibit directly influenced on stock prices in several markets. Zalla (2016) showed that EPU negatively influenced macroeconomic and financial indicators including stock exchange performance, interest rates, industrial production, and employment. Arbatli et al. (2017) established that political and economic events such as elections, leadership changes, the 2011 US debt downgrade, Brexit, and Japan's consumption tax announcement generated EPU, reducing investment, employment, and output in Japan.

Despite these contributions, prior studies often omitted key variables such as crude oil prices, money supply, and foreign direct investment when examining EPU and capital market development, highlighting a control variables and methodological gaps. Riaz, Hongbing, Hashmi, and Khan (2018) found that unpredictable policies negatively affected US stock returns in the transportation sector. Abdullah (2020) showed that stock returns in Gulf countries were

heavily influenced by US EPU. Rehman and Apergis (2019) reported that policy uncertainty adversely affected investor sopiness in Asian and European markets between 1995 and 2015. Within Nigeria, Ogbuabor, Onuigbo, Orji, and Ojonta (2021) documented a consistent long-term negative connection between EPU and the All Share Index. Salisu et al. (2023) also found that EPU had adverse effects on exchange rates and stock prices. Similarly, studies examining geopolitical risks, climate policy uncertainty, and COVID-19-related uncertainties (Caldara & Iacoviello, 2022; Faccini, Matin, & Skiadopoulos, 2021; Salisu & Akanni, 2020; Narayan, Iyke, & Sharma, 2021) concluded that such events negatively affected economic growth.

Overall, most existing research has focused on the effects of EPU on stock market performance and other variables such as the All Share Index, interest rates, exchange rates, industrial production, and employment, both in Nigeria and internationally. However, no known studies have explored how Political Stability (PS) mediate with EPU on capital market development measured by market capitalization ratio to GDP. This study aims to fill the empirical gap and develops its hypotheses based on the evidence and limitations identified in previous research. Based on empirical gap identified, this study hypothesized that;

H₀₁: Economic Policy Uncertainty (EPU) have no significant influence on capital market development proxied with stock market capitalization in Nigeria.

H₀₂: Political Stability (PS) has no significant mediating influence with Economic Policy Uncertainty (EPU) on capital market development proxied with stock market capitalization in Nigeria

3. Methodology

This study employed secondary data and adopted a quantitative research approach based on an ex-post facto research design. Annual data were obtained for the construction and measurement of the Economic Policy Uncertainty (EPU) index, Political Stability (PS) index, and stock market size, proxied by stock market capitalisation. The data were sourced from the World Uncertainty Index database, developed using the news-based methodology of Baker et al. (2016), the Worldwide Governance Indicators (WGI), Nigerian Exchange (NGX) Fact Books, and the reports of the Central Bank of Nigeria (CBN). The study covered the period from 1995 to 2024. To determine the time-series properties of the variables and establish their order of integration, the study conducted unit root tests using the Augmented Dickey-Fuller (ADF), Phillips-Perron (PP), and Ng-Perron procedures. The Autoregressive Distributed Lag (ARDL) modelling approach developed by Pesaran et al. (2001) was subsequently employed to examine the relationships among the study variables. The ARDL model specified for the study is presented in Equations 1 and 2 below.

General ARDL Equation

$$Y_t = \alpha_0 + \sum_{i=1}^p \phi_i Y_{t-i} + \sum_{j=1}^{q_1} \beta_{1j} X_{1,t-j} + \sum_{j=1}^{q_2} \beta_{2j} X_{2,t-j} + \cdots + \sum_{j=1}^{q_k} \beta_{kj} X_{k,t-j} + \varepsilon_t \quad \text{Equation 1}$$

$$\ln SMCAP_t = \alpha_0 +$$

$$\gamma_1 \ln EPU_t + \delta_2 \ln MS_t + \theta_3 \ln INT_t + \vartheta_4 \ln COP_t + \pi_5 \ln FDI_t + \varepsilon_t - - \text{Equation 2}$$

Since the study variables were subjected to Unit roots, the data exhibit mix reaction of I(0) and I(1) (see table 4). This enables the study to used ARDL model for hypotheses 1 and 2 below.

- ARDL model for Hypothesis One

$$\begin{aligned}\Delta \ln \text{SMCAP}_t = & \alpha_0 + \sum_{i=0}^n \beta_i \Delta \ln \text{SMCAP}_{t-i} \\ & + \sum_{i=0}^n \gamma_i \Delta \ln \text{EPU}_{t-i} + \sum_{i=0}^n \delta_i \Delta \ln \text{MS}_{t-i} + \sum_{i=0}^n \theta_i \Delta \ln \text{INT}_{t-i} \\ & + \sum_{i=0}^n \vartheta_i \Delta \ln \text{COP}_{t-i} + \sum_{i=0}^n \pi_i \Delta \ln \text{FDI}_{t-i} + \phi_1 \ln \text{SMCAP}_{t-1} + \partial_2 \ln \text{EPU}_{t-1} + \forall_3 \ln \text{MS}_{t-1} \\ & + \phi_4 \ln \text{INT}_{t-1} + \omega_5 \ln \text{COP}_{t-1} + \pi_6 \ln \text{FDI}_{t-1} + \varepsilon_t - \text{Equation 3}\end{aligned}$$

- ARDL model for Hypothesis Two – After Mediating

$$\begin{aligned}\Delta \ln \text{SMCAP}_t = & \alpha_0 + \sum_{i=0}^n \beta_i \Delta \ln \text{SMCAP}_{t-i} \\ & + \sum_{i=0}^n \gamma_i \Delta \ln \text{EPU} * \text{PS}_{t-i} + \sum_{i=0}^n \delta_i \Delta \ln \text{MS}_{t-i} + \sum_{i=0}^n \theta_i \Delta \ln \text{INT}_{t-i} \\ & + \sum_{i=0}^n \vartheta_i \Delta \ln \text{COP}_{t-i} + \sum_{i=0}^n \pi_i \Delta \ln \text{FDI}_{t-i} + \phi_1 \ln \text{SMCAP}_{t-1} + \partial_2 \ln \text{EPU} * \text{PS}_{t-1} \\ & + \forall_3 \ln \text{MS}_{t-1} + \phi_4 \ln \text{INT}_{t-1} + \omega_5 \ln \text{COP}_{t-1} + \pi_6 \ln \text{FDI}_{t-1} + \varepsilon_t - \text{Equation 4}\end{aligned}$$

Where;

SMCAP – Stock Market Size Capitalisation proxy for Capital Market Development

EPU – Economic Policy Uncertainty

MS – Money Supply

INT – Interest Rate

COP – Crude Oil Price

FDI – Foreign Direct Investment

PS – Political Stability

4. Results and Discussions

The preliminary statistics shown in Table 2 below.

Table 1: Summary of Descriptive Statistics of Variables

Statistics	Mean	Max	Min	S/D	Skew	kurt	Jarque-Bera (JB)	Prob
EPU	371.35	577.14	223.74	74.36	0.20	2.89	1.73	0.044
INT	11.91	18.72	7.71	3.05	0.54	1.16	7.031	0.030
MS	32724.8	69841.9	20989.8	9432.6	0.73	2.38	8.210	0.407
COP	48.01	98.43	6.43	2.28	0.34	1.45	12.583	0.130
FDI	102.89	784.54	119.78	3.98	1.73	1.93	9.873	0.054
SMCAP	93.87	928.57	247.58	4.82	2.15	1.41	2.873	0.643
PS	1.20	2.20	1.5	1.08	1.32	1.04	3.021	0.521

Source: Author's Computations (2026)

The descriptive statistics in Table 1, as reflected by the skewness and kurtosis values, summarize the distributional patterns of the study variables. Results from the Jarque-Bera test show that

EPU, INT, and FDI deviate from normality, as their associated probabilities fall below the 5 percent level. Conversely, MS, COP, and Stock Market Size Capitalisation (SMCAP) exhibit normal distribution characteristics, given that their Jarque–Bera probabilities exceed 5 percent. Further examination of the skewness and kurtosis statistics indicates that all variables such as EPU, INT, MS, COP, FDI, and SMCAP are skewed to the right, implying a general upward movement over time. Nevertheless, despite these observed increases in MS, INT, EPU, COP, and SMCAP, entrenched political stability and bureaucratic constraints within Nigeria’s institutional framework may have limited the extent to which these policies trends translated into overall capital market development.

Correlation Test

Table 2 focused on relationship among study variables and signifying that there is no problem of multi-collinearity in the model, according to the results.

Table 2: Correlation Matrix

Variables	EPU	INT	MS	COP	FDI	SMCAP	PS
EPU	1.0						
INT	-0.23	1.0					
MS	0.63	-0.46	1.0				
COP	-0.16	0.17	-0.14	1.0			
FDI	-0.50	0.20	0.22	0.22	1.0		
SMCAP	-0.03	-0.52	0.22	0.32	0.20	1.0	
PS	-0.22	-0.19	-0.29	0.42	-0.13	-0.13	1.0

Source: Author’s Computation (2026)

Stationarity Tests

Table 3: Unit-Root Test for Study Variables

Variables	ADF		Ng-Perron unit root test		PP		Integration
	Level	First Difference	Level	First Difference	Level	First Difference	
EPU	1.273	6.943**	1.014	4.432**	2.054	5.093**	I(1)
INT	4.032**	-	3.590**	-	3.984**	-	I(0)
MS	1.532	4.643**	1.983	7.435**	0.943	5.095**	I(1)
COP	2.032	3.932**	0.620	4.945**	0.483	4.954**	I(1)
FDI	2.931**	-	4.821**	-	4.643**	-	I(0)
SMCAP	5.943**	-	4.841**	-	4.985**	-	I(0)
PS	1.329	3.841**	1.321	4.965**	1.543	5.632**	I(1)

Source: Author’s Computation (2026) @ 5% Level of Significance (**)

N.B; the study adopted 5% level of significance, where 1% (*), 5% (**) and 10% (***)

The unit root of the series for the research variables was shown in Table 3. The studied variables exhibit a mixed stationarity reaction. Therefore, the best estimate to use was Autoregressive Distributed Lag (ARDL).

Table 4: F-test results for ADRL bounds co-integration and Critical Values of the ARDL Test

Dependent Variable	Functional Model	F-statistics	Cointegration Status
STV	SMCAP = f(EPU, INT, MS, COP, FDI, PS)	8.731	Cointegrated
Level of Significance	Lower Bound I(0)		Upper Bound I(1)
1%	2.92		3.26
5%	3.83		6.24
10%	1.72		3.61

Source: Author's Computation (2026) ** denote significance at 5% level

There is proof of a long-term link between the research variables, according to the limits test results shown in Table 4. In particular, the null hypothesis of no cointegration is rejected since the computed F-statistic of 8.731 is more than the upper bound critical value I(1) of 6.24. This result demonstrates that the variables move in tandem over time.

Table 5: ARDL Short Run Error Correction and Long Run Estimates - Before Mediating

Short Run Error Correction				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
Δ SMCAP	-0.119	0.101	-1.178	0.242
Δ EPU	-1.625	1.013	-5.011	0.021
Δ INT	-2.083	1.073	-6.253	0.000
Δ COP	-0.144	1.007	-3.513	0.000
Δ MS	0.325	1.003	7.151	0.000
Δ FDI	-0.201	1.002	-0.186	0.852
CointEq(-1)	-0.436	0.067	-8.130	0.000
Long Run Coefficients				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
EPU	-2.363	0.589	-5.231	0.001
INT	9.704	1.965	4.837	0.000
COP	-0.213	0.018	-8.502	0.000
MS	0.482	0.049	9.793	0.000
FDI	0.010	4.237	0.002	0.218
C	-0.001	0.003	-0.185	0.853

Dependent Variable: SMCAP

Notes: $R^2 = 0.558$, Adjusted $R^2 = 0.547$, F-statistic = 78.721, Prob(F-statistic) = 0.000 and Durbin-Watson stat = 1.836

Source: Author's Computation (2026)

**** denotes significance level at 5% and Δ denotes first difference operator**

The ARDL estimates presented in Table 5 provide evidence on the short and long-runs effects of explanatory variables on market size capitalisation (SMCAP). In the short run, EPU exhibit adverse and significant effect on SMCAP ($\beta = -1.625$, $t = -5.011$, $p < 0.05$). Similarly, INT ($\beta = -2.083$, $t = -6.253$, $p < 0.05$) and COP ($\beta = -0.144$, $t = -3.513$, $p < 0.05$) exerted weighty adverse influences on SMCAP. By contrast, money supply (MS) had optimistic and substantial influence on SMCAP ($\beta = 0.325$, $t = 7.151$, $p < 0.05$), while FDI depicted negative but worthy and trivial

effect in the short run ($\beta = -0.201$, $t = -0.186$, $p > 0.05$). These results indicate that EPU, interest rate, crude oil price, and MS were the major short-run determinants of stock market size capitalization in the NGX. In the long run, FDI established a direct but inconsequential connection with SMCAP ($\beta = 0.010$, $t = 0.002$, $p > 0.05$), MS exhibit ($\beta = 0.482$, $t = 9.792$, $p < 0.05$) and interest rate ($\beta = 9.704$, $t = 4.837$, $p < 0.05$) exerted direct and substantial effects on stock market size capitalisation, whereas economic policy uncertainty ($\beta = -1.625$, $t = -5.011$, $p < 0.05$) and COP ($\beta = -0.213$, $t = -8.502$, $p < 0.05$) had substantial negative impacts.

Overall, the findings suggest that uncertainty-related information, interest rates, COP, and FDI play crucial roles in determining stock market size capitalisation in Nigeria. Heightened economic policy uncertainty discourages investor participation and reduces market capitalisation. Moreover, persistently high interest rates set by the CBN reduce investors' willingness to borrow for equity investment, while fluctuations in crude oil prices dampen confidence in listed oil and gas firms. These results highlight the importance of carefully managing EPU, interest rates, money supply, crude oil prices, and foreign direct investment to enhance investor confidence and deepen Nigeria's stock market. The adjusted coefficient of determination (Adj. R^2) of 0.547 indicates that about 54.7 percent of the variation in stock market size capitalisation (SMCAP) is accounted for by the explanatory variables included in the model. The overall model is statistically sound, as shown by an F-statistic of 78.721 with a probability value of 0.000. Furthermore, the Durbin-Watson statistic, which is approximately 1.8, suggests that the model is not affected by serious serial correlation.

The short-run dynamic influence of EPU and the other explanatory variables on SMCAP are presented in Table 5. The (ECT_{t-1}) carries a negative and statistically significant coefficient, indicating a stable adjustment process toward long-run equilibrium. Specifically, any short-run deviation from equilibrium is corrected at an annual speed of about 43.6 percent. This result leads to the rejection of the null hypothesis that economic policy uncertainty has no significant effect on stock market size capitalization. Previous empirical evidence such as Fakunmoju (2024), Ogbuabor et al. (2021), Rehman and Apergis (2019), as well as Riaz et al. (2018), which show that economic policy uncertainty significantly affects the Nigerian stock market development through indicators such as the All Share Index and stock returns. However, unlike these earlier studies, the present research directly demonstrates the effect of economic policy uncertainty on stock market size capitalisation, thereby contributing new insights to the literature.

Table 6: ARDL Short Run Error Correction and Long Run Estimates – Hypothesis Two - After Mediating for Political Stability (PS)

Short Run Error Correction				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
Δ SMCAP	-0.723	0.321	-3.162	0.042
Δ EPU*PS	-1.035	0.423	-4.621	0.001
Δ INT	-2.543	0.159	-4.723	0.010
Δ COP	0.674	0.306	2.913	0.040
Δ MS	0.315	0.103	1.151	0.540
Δ FDI	-0.761	0.302	-4.176	0.042
CointEq(-1)	-0.247	0.046	-9.760	0.001
Long Run Coefficients				

Variable	Coefficient	Std. Error	t-Statistic	Prob.
EPU*PS	-1.323	0.632	-7.431	0.000
INT	0.523	1.208	4.067	0.001
COP	-0.213	0.018	-1.502	0.070
MS	0.952	0.319	9.793	0.000
FDI	0.010	4.237	4.202	0.018
C	-0.001	0.303	-0.139	0.358

Dependent Variable: SMCAP

Notes: $R^2 = 0.690$, Adjusted $R^2 = 0.717$, F-statistic = 108.541, Prob(F-statistic) = 0.000 and Durbin-Watson stat = 1.986

Source: Author's Computation (2026) ** denotes significance level at 5% and Δ denotes first difference operator

Table 6 depicted that short-run ARDL model depicted that interactive influence of PS with EPU, INT and FDI had negative and significant influenced on SMCAP while mediate influence of PS with COP had positive and significant effect on SMCAP as well as MS had positive and insignificant effect on SMCAP. This means that mediating influence of PS was paramount and significantly determined SMCAP and that increase in political instability ranking in Nigeria scare away domestic and foreign stock investors in patronizing Nigeria stock exchange which caused sharp declined in stock market size capitalization to gross domestic product. Lastly, Adj.R² value was 0.717 indicated that roughly 71.7% of SMCAP variability explained by explanatory variables (EPU, INT, COP, MS, FDI) mediate with PS and that Prob(F-statistic) = 0.000 and an F-statistic of 108.541, shown that entire model is statistically fitted and free from serial autocorrelation problem since the Durbin-Watson statistic was closed to 2.0. Thus, the model for this study is well fitted.

To established the mediating influence of PS, the Adj.R² i.e coefficient of determination depicted in Table 5 and Table 6, that for hypothesis one Adj.R² = 0.547 (54.7%) stands for before mediating influence of PS with EPU, INT, COP, MS and FDI while after mediating influence of PS the Adj.R² = 0.717 accounted for 71.7% variance in SMCAP. This increased in the Adj.R² insinuates that PS play a significant role in the stock market size capitalization which negatively influenced overall Nigeria stock exchange market size since there exist change in Adj.R² = 0.547 (54.7%) from hypothesis one to Adj.R² = 0.717 (71.7%) for hypothesis two. Studies such as Omodero and Dandago (2018), Akinlabi et al. (2011), Bolgorian (2012), Hasan, and Nuri (2013), Nwankwo (2014) and O'Toole and Tarp (2014) supported the finding of this study that low rating of Nigeria Political stability adversely influence stock market size capitalization proxied for capital market development in Nigeria. Thus, this study rejected the null hypothesis two formulated. This indicates that GE significantly mediate with EPU to determine capital market development in Nigeria.

Table 7: Post Estimate Result - After Mediating Influence of Political Stability (PS)

Model	Breusch-Pagan-Godfrey Heteroscedasticity Test:		Breusch-Godfrey Serial Correlation LM Test	
	F-statistic	P- value	F-statistic	P-value
SMCAP	1.433	0.232	1.624	0.521

Source: Author's compilation (2026)

Since the diagnostic tests demonstrate that the post estimate model in table 8 above is free from both serial correlation and heteroskedasticity, both of which have p-values greater than 5% and it satisfies the primary linearity assumptions.

5. Conclusion and Recommendations

In view of the findings, it was revealed that EPU determined stock market size capitalization as well as PS strongly mediate with EPU which significantly affect stock market size capitalization in the Nigeria capital market. Thus, the study concluded that EPU and mediating of PS with EPU influence stock market size capitalisation in Nigeria. The EPU Index, PS, INT, FDI, COP, and MS influence their decision to trade on the Nigerian stock market which in turn enhance capital market development. The study uses INT, FDI, COP, and MS as control variables to determine the size capitalization of the Nigerian stock market, thereby developing a novel measure of stock investors' exposure to EPU and PS as major instrument for capital market patronage which enable capital market development. Nigeria is a developing country with unstable macroeconomic policies and ineffectiveness in government policies, so before investing in the Nigerian capital market, investors both inside and outside of Nigeria should give sound consideration economic policies, INT, FDI and COP and MS.

Also, the study concluded that PS negatively influence stock market size capitalization and that the fight against Government ineffectiveness in Nigeria should be tackled seriously because it has become so ingrained in the Nigerian system that all attempts to eradicate corrupt and bureaucratic practices seem to fail due to Government ineffectiveness, which makes Nigeria to ranked very low in political stability in the global space and thus led to one of the highest rate corrupt nation in the World. This makes both domestic and foreign stock investors avoid patronizing Nigeria stock exchange which caused drop in stock market size. However, the study only considers Nigeria, which serves as the limited of the study. The findings of the study cannot be generalized and further study should focus on how this study title can be replicated in Sub-Saharan and North Africa countries. To achieve capital market development via sound improvement in stock market size capitalization, the study advises Nigerian policymakers to provide clear, consistent, and timely information regarding government policy direction to investors and other economic participants, this will boost more stock investors patronage in the Nigeria stock market which in turn increase market size capitalization. A predictable and investor-friendly macroeconomic policy environment such as INT and MS are crucial for the sustainable development of the Nigerian stock market, as it would encourage greater trading activity and participation, thereby supporting growth in stock market size capitalization. Ongoing uncertainty linked to issues such as insecurity, farmer-herder clashes, ethnic and religious divisions, exchange-rate policy adjustments, and Government ineffectiveness in policies create significant threats to market stability and investor confidence.

The study further recommends that domestic investors adopt sectoral diversification strategies within stock or securities traded in the Nigerian capital market to reduce exposure to risks associated with volatile policy conditions, particularly those securities affect by money supply, interest rates, and crude oil price fluctuations. Such diversification can help stabilize returns and promote higher stock market turnover which enhance increment in stock market size capitalization. In addition, Government ineffectiveness over corruption practices and bureaucratic process and documentation hinder strong political commitment of enforcing

transparent, impartial, and effective measures in the Nigeria capital market. Drawing lessons from the “Asian Tiger” economies, the Nigeria Government can adopt a policy-oriented with political stability framework which could strengthen market discipline and promote higher levels of capital market development. Lastly, the study recommended that ensuring rigorous information disclosure and comprehensive access to relevant data for firms seeking capital would enhance price discovery, boost investor trust, and ultimately contribute to increased stock market size capitalization in Nigeria.

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